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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 522

MANUFACTURERS' FINANCE COMPANY,
Petitioner,

vs.

FRANK M. McKEY, as Trustee in Bankruptcy of the Estate of GRIGSBY-GRUNOW COMPANY,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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Respondent, at the beginning of his brief, states that the Grigsby-Grunow Company was adjudicated bankrupt March 10, 1934.

The record shows that respondent was appointed as trustee under a petition in bankruptcy filed February 18, 1934 (R. 90) after this matter was disposed of in the trial court (R. 83) and the record filed in the Circuit Court of Appeals (R. 83). When the decree of the District Court was entered all that was before the court was the intervening petition and the receivers' answers. No question of the solvency of the company was raised in the pleadings, evidence or stipulations of fact.

We desire to point out that the main suit was filed November 23, 1933 by a creditor, with a claim in excess of $3,000 who prayed for the appointment of a receiver (R. 2). The following day the company answered, admitting the averments of the bill and joined in the prayer thereof (R. 6), whereupon the District Court appointed the vice president of the company (R. 52) and counsel for respondent, as receivers (R. 7) who qualified the same day (R. 10). The bill of complaint alleged that the company had assets of over $28,000,000 and over $23,000,000 in excess of liabilities (R. 3). This appeal was perfected, briefs were filed and the matter set for oral argument in the Court of Appeals on April 27, 1934 (R. 88) on which date leave was given to respondent to become substituted as a defendant in lieu of the equity receivers (R. 90).

The point we are making is that this matter was wholly disposed of in the District Court and this appeal was prayed, allowed and perfected before the adjudication in bankruptcy was made. Obviously the purpose of mentioning the adjudication in bankruptcy at the commencement of respondent's brief is to gain a sympathetic response. The company's financial condition was not a matter that was considered by the trial court when the decree was entered. The company's strong financial condition was apparently known to the trial court, for nowhere in its memoranda opinion (R. 70), findings of fact (R. 73) and conclusions of law (R. 75) does it appear that the company was insolvent. On the question of insolvency, the Circuit Court of Appeals had before it this record which affirmatively shows the Grigsby-Grunow Company to be amply solvent, and nowhere in the record is there any evidence otherwise (excepting by inference, resulting from the substitution), yet in several instances the Court of Appeals refers to the insolvent company. This fact, improperly before the Court of Appeals no doubt influenced the court in making its decision.

The gist of respondent's brief is that because petitioner *attempted* to collect interest and attorney's fees in accordance with the terms of the contract, this fact was so shocking to the conscience of the chancellor, that it justified the disallowance of all interest above seven per cent and that because the controversy involved only $3,096.22 (which we deny) the disallowance of attorney's fees was proper. At no time did respondent contend that there was any fraud, accident or mistake in the execution of the contract, or otherwise.

The trial court in its memoranda opinion (R. 70) conceded all of the contentions of petitioner (R. 71), but denied relief on the ground that (*a*) petitioner did not come into a court of equity with clean hands; (*b*) the receivers expended $35,000 for advertising, the purposes of which were to maintain the good will of the company and to preserve its receivables as live and valuable assets; and (*c*) petitioner's request for contract interest and attorney's fees was unconscionable.

The Court of Appeals evidently did not regard any of the foregoing contentions, excepting the last one and its opinion centers around the proposition that because appellant *attempted* to collect interest and attorney's fees in accordance with the terms of the contract, from an *insolvent* company, equity requires the disallowance of all interest in excess of seven per cent and the refusal of any attorney's fees.

Respondent gives three reasons on page 4 of his brief, why petitioner's claims were shocking to the court:

Respondent's Point I.

It evidenced an assertion of, and an insistence upon, a contract claim upon a basis more onerous than the petitioner had asserted against the company itself, and in excess of its profits under its contract as the petitioner and the company had themselves operated under that contract.

The contract provides for payment of interest or compensation calculated, not on the moneys advanced, but on the face amount of the accounts assigned and the rate was ten per cent of the face amount of accounts. Petitioner advanced fifty per cent of the amount of such accounts at the time of purchase and paid the balance to the company as the accounts were collected. This made the rate of return to petitioner twenty per cent per annum on the money advanced, without regard to the services rendered (R. 43, Par. 9; R. 47, 48). The contract permitted the company to make the collections on such assigned accounts and each day the company remitted such collections in kind to petitioner who, on receipt thereof, paid the balance of the purchase price.

Upon being appointed, the receivers promptly refused to carry out the terms of the contract and instead converted such collections to their own use, depositing the same in their special account (R. 19). This action by the receivers necessarily caused the rate of interest or compensation to increase, due to the fact that the return to petitioner was calculated on the face amount of accounts, thus the return was based on $550,000 in outstanding accounts each day until payment by the receivers was made to petitioner.

Several weeks elapsed from the date of the appointment before petitioner was able to procure any portion of the collections from the receivers, and then only on an order

of court. The receivers, on December 14, 1933 had $223,-973.55 of such collections which they resisted paying over and the District Court directed them to pay only $140,000 thereof, over the objections of the attorneys for the petitioner, and thereafter on December 22nd, there was a similar occurrence (R. 65). By reason of the receivers' actions in withholding such collections the rate increased from 20 per cent to an average of 28.3 per cent. This, respondent contends, is sufficient justification for denying to petitioner all of its rights under the contract. It might not be amiss at this point to suggest that the District Court might nave allowed interest at the rate in effect prior to the appointment of the receivers, but this the court did not see fit to do apparently on the general ground that all interest in excess of seven per cent is shocking to the conscience of the chancellor, and equity may refuse relief.

Respondent argues at page 2 of his brief that this was a complicated contract, apparently to show that the receivers did not understand it and did not know that the rate of interest was increasing by reason of their retaining the collections. In this connection, may we call the court's attention to the record, which shows that one of the receivers, LeRoi J. Williams, was the vice president of the Grigsby-Grunow Company and signed the contract (R. 52) and the other receiver, Thomas L. Marshall, who now appears as attorney for the respondent, and during the time of the receivership was the attorney for and director of Manufacturers & Dealers Finance Corporation (R. 29) to whom the Grigsby-Grunow Company had also sold certain of its accounts receivable, presumably under a similar contract, and was also the chief witness for the receivers (R. 29). To these gentlemen, one the head of a corporation which on September 9, 1933 had assets of over $20,000,000, and the other a member of the Bar and attorney and director of a finance company engaged in a business similar to petitioner, we submit the

contract was not complicated and was well understood by them. The record further discloses that the receivers, the day following their appointment, and *without notice* to petitioner, procured the District Court to enter an order authorizing the receivers to turn over to the petitioner funds collected by the receivers on assigned accounts *on the same basis as prior to the filing of the bill of complaint*, namely: to return to the receivers one-half of the collections received on assigned accounts (R. 63). Then the record shows that petitioner engaged counsel who immediately conferred with the receivers (R. 63). The receivers suggested that the petitioner pay over to the receivers one-half of assigned accounts collected, or permit the receivers to retain one-half thereof, which was not agreeable, petitioner contending that under the terms of the contract, various defaults had occurred and that its position was extremely hazardous, due to the type of accounts it had purchased. The receivers then had $50,000 in cash collected on such assigned accounts and the prospect of securing $100,000 more within a short time. Petitioner's counsel offered to take this $150,000 and for one-half the balance to accept short-term receivers' certificates, which proposition the receivers refused (R. 63, 64) and thereafter this intervening petition was filed (R. 13).

Respondent's Point II.

It evidenced an assertion of, and an insistence upon, a claim attorneys' fees in the amount of $7,800, whereas the total amount in dispute was $3,096.22.

At no time did petitioner ask for $7,800 as attorney's fees. In its intervening petition (R. 16) it asked for reasonable attorney's fees. The undisputed evidence showed the expenditure of sixteen days' time by the attorneys (R. 25, 26). A member of the Bar called by petitioner testified that in his opinion, based on an hypothetical question

submitted to him, $7,800 would be a reasonable fee. Our argument in full with respect to the amounts involved and the value of the services is covered at pages 22 to 25 of the petition for certiorari.

Respondent's Point III.

It evidenced an assertion of, and an insistence upon, such claims to the disadvantage of other creditors, though the Chancellor found that the work of the receivers and an expenditure by them of $35,000 in merchandise advertising, contributed substantially to the liquidity of the assigned accounts, a considerable portion of which were owed by persons who had purchased the merchandise for resale at wholesale or retail with contemplation of company advertising.

No mention is made by the Court of Appeals of the expenditure by the receivers of $35,000 in advertising and the District Court merely said that

> "Receivers have expended the sum of approximately $35,000 in an advertising campaign, one of the principal purposes of which was to maintain the good will of the defendant and to preserve the receivables of the defendant as live and valuable assets. The intervening petitioner has had benefit of the services of this court of equity."

Apparently respondent now contends that because the receivers expended $35,000 for advertising, relief should be denied to this petitioner. Nowhere in his brief does the respondent claim that the expense of the advertising should be charged to petitioner. December 1, 1933, the receivers filed a petition in which they say:

> "* * *
>
> Some forty distributors assembled in Chicago November 28, 1933 and in a meeting urged upon the receivers that a conservative advertising appropriation be made for immediate newspaper advertising in the

> 52 centers of the United States involved. The reasons for this request were preservation of the good will of the business, furthering of the moving of merchandise from dealers' and distributors' stores and warehouses, and fundamentally the building up of a foundation for the new lines in January and, above all the immediate showing to the public that the Majestic radios and refrigerators are not out of business and can still be bought with assurance that the business is being maintained and will be maintained." (R. 58.)

And on the same day the trial court entered an order authorizing said receivers:

> "In the operation of the business, to expend from the assets of the receivership estate for further advertising during the month of December, 1933 the sum of $35,000.00." (R. 61.)

How was petitioner to know that the receivers intended to ask that it pay a portion of the advertising expense, when not one word is mentioned in either the petition or the order. The receivers by their answer to the intervening petition contended that such advertising expense was incurred for the purpose of realizing on assigned accounts receivable. The testimony was that the $35,000 was not paid in cash, but was in the form of credit memorandums to customers to do advertising in their local territory (R. 25). Nowhere in the record does it appear that one cent of the $35,000 was expended in connection with any account assigned to petitioner. The District Court's finding in this respect was not based on anything in this record (R. 74). What amount the receivers were asking that appellant be required to pay or contribute is not expressed in the answer or in the finding by the court. Without any testimony or evidence of any kind the trial court could not have arrived at any amount that petitioner was to pay or be charged with. How the expenditure by the receivers of $35,000 for "advertising" helped to collect the assigned accounts, no one can determine. Whether the petitioner

profited by the expenditure is highly conjectural. The record does disclose that at the time the receivers were appointed petitioner had over $550,000 in assigned accounts and trade acceptances and the balance of money then due it was less than $275,000. Before the advertising appropriation was expended the Ford Motor Company paid the receivers $100,000, which account was then owned by petitioner (R. 64). There was then on deposit in the special account of the receivers over $50,000 resulting from collections on accounts held by petitioner (R. 64). Petitioner had indefensible trade acceptances in the sum of $85,647.22 (R. 64). The last three amounts total $235,647.22. Following the receivers' contention to a logical conclusion one finds that before one cent of the advertising appropriation was spent, less than $40,000 would have paid off all claims of petitioner, and petitioner had accounts in the sum of $314,352.75, out of which it could collect such balance. To collect $40,000 the receivers contend they spent $35,000 for advertising which "redounded to the benefit of petitioner" and hence infer that petitioner should pay for such advertising. We submit that the proof in this case shows that the advertising appropriation was obviously made for the purpose of retaining the good will of the distributors and as the receivers said in their petition that one of the purposes of such expenditure was:

> "Above all the immediate showing to the public that the Majestic radios and refrigerators (product of Grigsby-Grunow Company) are not out of business and can still be bought with assurance that the business is being maintained and will be maintained." (R. 58.)

Before the receivers were appointed the accounts apparently were paying in due course, but perhaps because the receivers were appointed the distributors were worried whether the Grigsby-Grunow Company would continue in business and the receivers, in order to assure the distribu-

tors of the continuance of the business and to preserve their good will and patronage, made this expenditure. If the receivers expected contribution for such advertising, why was not that matter discussed with petitioner or its counsel? Why was not something set forth in the petition that the advertising expenditure was to liquidate the accounts that had been assigned to petitioner, and why was there no request of the court that an order be entered directing that a portion of such advertising expense should be borne by petitioner, thereby giving petitioner an opportunity to be heard, and presenting its point of view?

Taking into consideration the petition for advertising filed by the receivers and the order entered in connection therewith, it is clear that at the time that matter was presented to the District Court no thought existed in the minds of the receivers that any part of the expense of advertising was to be charged to petitioner.

In the *Matter of Lutz & Schramm Company, Inc.*, 38 A. B. R. 351, page 356, the court said:

> "The collection of the accounts by them (receivers) was for the benefit of the bankrupt estate so as not to interfere with the preservation of the good will."

The District Court did not impose any conditions on petitioner before granting it any relief. The court merely infers that because petitioner has had the benefit of the services of the court of equity, it has had ample relief. To follow the court's decision to a conclusion, one finds that the conscience of the court below was not shocked when it required the receivers to pay interest at the rate of twenty per cent, but when it found that due to the retention of the collections by the receivers the interest increased to an average of 28.3 per cent, then its conscience was so shocked that all interest in excess of seven per cent was disallowed. The point we are making is that 20 per cent was not shocking, but 28.3 per cent was, and therefore only seven per cent was allowed. Without seeming to

beg the question, we might suggest that the court, notwithstanding the experience of the receivers in this particular business, could have made an allowance of interest at the rate in effect prior to the appointment of the receivers.

Respondent quotes copiously from the opinion of the District Court and the Court of Appeals and at page 6 says: "The foregoing opinions are amply supported by authorities." Not one authority is cited and it strikes us as singular that respondent has made no attempt to distinguish the instant case from the multitude of decisions to the contrary, cited in our petition for the writ.

At page 7 of the brief, respondent contends that the case of *In re: International Raw Materials Corporation,* 22 Fed. (2) 920, and *Merchants & Manufacturers Securities Company* v. *Johnson,* 69 Fed. (2) 940, both relied on by petitioner, involved facts different than those in the instant case. In the *International Raw Material* case the facts are identical and cannot be distinguished. That case, this court will remember, is the one that criticized the case of *Chicago Reed & Furniture Company,* 7 Fed. (2) 885 (7th Circuit), the opinion on which the Court of Appeals predicated the instant decision.

In the case of *Merchants & Manufacturers Securities Company* v. *Johnson,* 69 Fed. (2) 940, six per cent interest after receivership was the only prayer of the finance company. That case involved questions of doing business in Missouri without authority as a foreign corporation and involved the construction of the State constitution which provides for the forfeiture of the lien of a pledge if interest in excess of eight per cent is exacted. Both questions in so far as they related to a finance company doing business in Missouri had never been passed upon and those being the more important questions in the case the finance company did not question the allowance of interest after the appointment of the receiver. Certiorari in that case was denied by this Honorable Court October 8, 1934.

The only other case cited by respondent is *LeSeuer* v. *Manufacturers Finance Company,* 285 Fed. 490 in which the facts were different. There, a contract was entered into between petitioner and the manufacturing company for the purchase of accounts receivable. The manufacturing company became financially involved and by action of its stockholders a committee was appointed to take charge of and liquidate its business and subsequently a *new* agreement was entered into between the committee, the manufacturing company and petitioner, by which the manufacturing company agreed to forward by mail to petitioner all original remittances and collections on accounts theretofore purchased, the contract containing the proviso,

> "With authority to the latter (finance company) to apply the same in accordance with the terms of the original contract of July 26, 1912, but without prejudice to the rights of the manufacturing company and its committee with respect to the matter of usury or any other matters under that contract and the transactions had thereunder."

For a short period thereafter, the committee remitted collections and thereafter refused so to do, contending that the contract was usurious and void, and that the finance company was doing business in Tennessee without authority. Petitioner filed its bill of complaint asking for a decree against the liquidating committee, requiring such committee to deliver up all the accounts not collected and in default, or for the amount thereof, as well as for other relief. The defense was that the contract was usurious and the proceedings thereunder void, and that petitioner was doing business in Tennessee without authority. The District Court first held that the contract was usurious under the laws of Maryland and void, and entered a decree accordingly. The court's attention was then called to a decision by the Court of Appeals of Maryland and the court then held after a reargument of the case, that the loans

were not void, but the only effect of usury was to void the excessive interest over the legal rate. The first decree was set aside and the matter referred to a master, who found that the company was entitled to recover their advances plus six per cent interest and rejected the defendant's contention that the petitioner should be charged with expenses incurred in collecting the assigned accounts. A final decree was entered in accordance with the report of the master, and affirmed by the Court of Appeals, and with respect to the cost of the collections to the liquidating committee, the court says (page 500):

"In our opinion, however, the liquidating committee should have been allowed the cost of the collections which it made, the amount of which, as shown by the uncontested evidence, is $4,446.52. True, by the agreement of 1912 between the finance company and the manufacturing company, the latter was to make collections at its sole expense and in the agreement of July 30, 1914 between the liquidating committee and the finance company the former agreed to forward remittances for the accounts collected, 'in accordance with the terms of said contract of July 26, 1912,' there being, however, otherwise no reference, direct or indirect, to the cost of collections. The manufacturing company, however, is *insolvent;* its general creditors cannot be paid in full; the decree in plaintiff's favor exhausts the entire fund in the committee's hands arising from the collection of the assigned accounts; and unless expense of the collections by the committee upon these accounts is paid out of the amounts collected, the result is that such expense must be paid by general creditors. Assuming that the committee had power to pay the expenses out of general assets, provided there remained sufficient to pay general creditors in full, not only is it open to serious doubt whether the committee had power to make such agreement as against general creditors of the insolvent estate (especially in view of the terms of the stockholders' assignment to the committee), but in our opinion to impose such liability would be inequitable as against general creditors."

Obviously, the situation in the *LeSeur* case was different than in the instant case. Here, receivers were appointed to operate the business of the solvent corporation having assets of $23,000,000 over and above all liabilities (R. 3). The receivers, after protecting themselves with a court order made a present of credits in the sum of $35,000 to their distributors to retain their good will and to continue their business relationship. In the *LeSeuer* case the company was *insolvent* and there was proof of the actual cost (to general creditors) of making the collections. Here, so far as the record discloses there were assets more than sufficient to discharge the claims of all creditors in full and the only ones affected would be the stockholders of the company.

CONCLUSION.

Since 1925 and commencing with the case of *In re: Chicago Reed & Furniture Company,* 7 Fed. (2) 885, and now followed in the instant case, a grave uncertainty has existed in the Federal Courts in Illinois with respect to corporations obligating themselves to pay interest in excess of seven per cent. The Bar have no way of knowing what rate of interest the District Court will enforce in a suit in equity. The amount involved here and the claim for attorney's fees are of minor importance. The decision of the court below is in conflict with the decisions of the Circuit Court of Appeals for the 2nd and 8th Circuits on exactly the same matters, and the court below has decided an important question of local law in conflict with the laws of Illinois, as construed by the Illinois courts. It has likewise refused to recognize that established policy which requires Federal courts sitting in Illinois to follow the decisions of the Illinois courts on questions of interest or usury.

We respectfully insist that manifest error appears in the decision below which can and should be settled by this Honorable Court's ruling, and that therefore the petition for writ of certiorari should be granted.

Respectfully submitted,

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